

# Government Policy and Strategy for SME Development

**J.P.D.R Jayasekara & Anuradha Thilakarathna**  
**Ministry of Finance and Planning, Sri Lanka**

**The Fourth IMF-Japan High-Level Tax Conference For Asian Countries in Tokyo**  
**April 2-4, 2013**

# Outline

## 1. Country Profile

1. Overview
2. Key Social Indicators
3. Key Economic Indicators

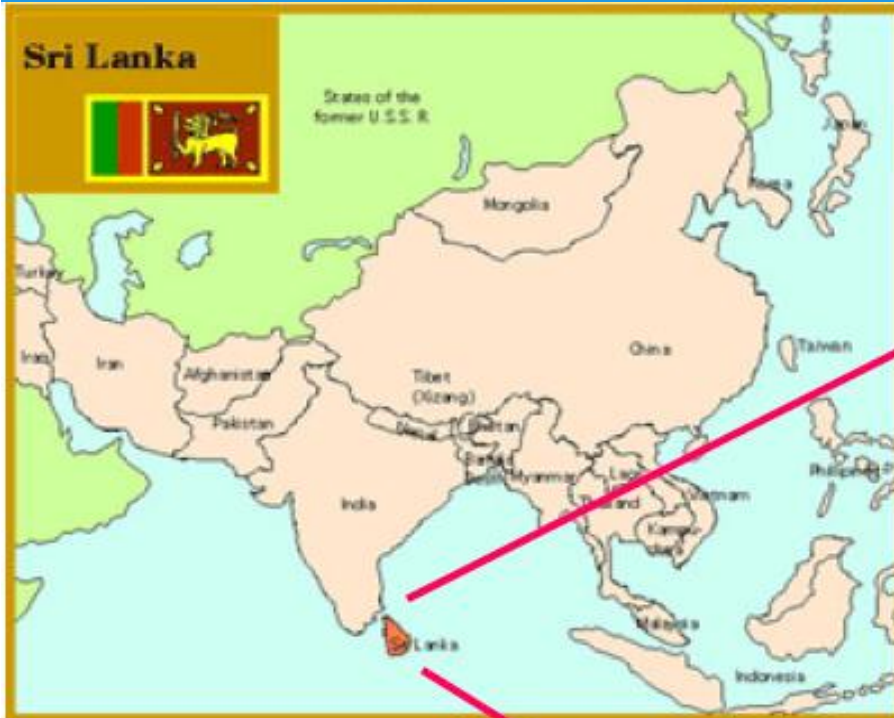
## 2. SMEs - Definition

## 3. Importance of SME in the Economy

## 4. Government Policy Framework and SMEs

## 5. Recent Policy Changes related to SMEs

# Sri Lanka



## Location

Between  $5^{\circ} 55'$  &  $9^{\circ} 50'$  North Latitude  
&  $79^{\circ} 42'$  &  $81^{\circ} 53'$  East Longitude



## Pearl of the Indian Ocean

Set in the Indian Ocean in South Asia, the tropical island nation of Sri Lanka has a history dating back to the birth of time. It is a place where the original soul of Buddhism still flourishes and where nature's beauty remains abundant and unspoilt.

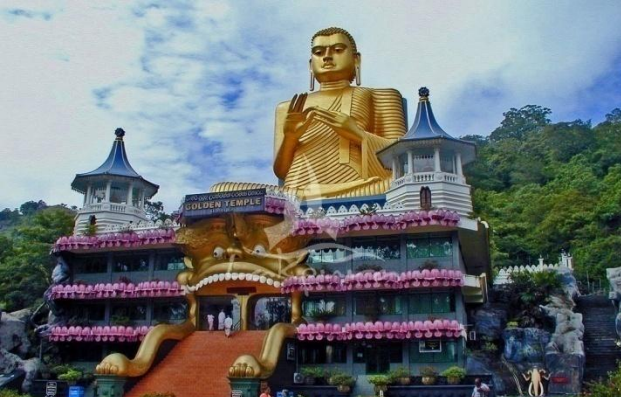
Few places in the world can offer the traveler such a remarkable combination of stunning landscapes, pristine beaches, captivating cultural heritage, and unique experiences within such a compact location. Within a mere area of 65,610 kilometers lie 8 UNESCO World Heritage Sites, 1,330 kilometers of coastline - much of it pristine beach - 15 national parks showcasing an abundance of wildlife, nearly 500,000 acres of lush tea estates, 250 acres of botanical gardens, 350 waterfalls, 25,000 water bodies, and a culture that extends back to over 2,500 years.

This is an island of magical proportions, once known as Serendib, Taprobane, the Pearl of the Indian Ocean, and Ceylon.

[www.srilanka.travel](http://www.srilanka.travel)



# UNESCO World Heritage



# Key Social Indicators

Description	Unit	Base Year	Value
Mid-year population	'000	2012	20,277
Population density	persons per sq. km.	2012	323.0
Growth of Population	%	2012	0.7
Life Expectancy at Birth	Years	2011	74.9
Infant Mortality Rate	Per 1,000 Live Births	2007	8.5
Maternal Mortality Rate	Per 100,000 Live Births	2011	41.6
Crude Birth Rate	Per 1,000	2010	17.6
Crude Death Rate	Per 1,000	2010	6.2
Literacy Rate (%)	%	2010	91.9
Literacy Rate - Computer	%	2009	20.3
Access Electricity	%	2011	91.0
Access to Safe Drinking Water	%	2011	84.0

# Key Economic Indicators

Description	2000	2006	2007	2008	2009	2010	2011
GDP (Billions of Rs)	1,258	2,939	3,579	4,411	4,835	5,604	6,543
Per Capita GDP (US\$)	899	1,421	1,617	2,014	2,057	2,400	2,836
GDP Growth	6.0	7.7	6.8	6.0	3.5	8.0	8.3
Consumption (% of GDP)	82.6	83.0	82.4	86.1	82.1	80.7	84.6
Investment (% of GDP)	28.0	28.0	28.0	27.6	24.4	27.6	29.9
Trade Balance (Millions of US\$)	-1,798	-3,370	-3,657	-5,981	-3,122	-4,825	-9,710
Exchange Rate (Rs/US\$)	75.78	103.96	110.62	108.33	114.94	113.06	110.57
Gross Official Reserves (Millions of US\$)	1049.0	2836.7	3508.2	2401.9	5357.4	7196.5	6748.1
Revenue & Grants (% of GDP)	17.2	17.3	16.6	15.6	15.0	14.9	14.5
Expenditure (% of GDP)	26.7	24.3	23.5	22.6	24.9	22.9	21.4
Overall Deficit (% of GDP)	-9.5	-7.0	-6.9	-7.0	-9.9	-8.0	-6.9
Government Debt (% of GDP)	96.9	87.9	85.0	81.4	86.2	81.9	78.5



# SMEs - Definition

- SMEs are defined in variety of ways by various countries using such parameters as:
  - Number of persons employed
  - Amount of capital invested
  - Amount of turnover or nature of the business

## In Sri Lanka:

- An enterprise with fewer than 50 people and capital investment less than 5 million Rs (*Department of Small Industries*)
- An enterprise with less than 8 million Rs investment and less than 50 million Rs annual turnover (*Export Development Board*)

- The World Bank states that:
  - if any enterprise has below 99 people, it can be defined as an SME.

- Hence, a clear definition is needed to:
  - provide concessionary financial facilities on a targeted basis **and**
  - provide specific business development service
- Therefore, the Department of Census & Statistics has started an “Economic Census” in 2013/14 with a key objective to prepare a unique definition for Micro-Small, and Medium Enterprises in Sri Lanka



# Importance of SMEs in the Economy (1)

- SME sector is considered the core segment of economic development in the country
- The country has a SME economy:
  - 70% of plantation sector;
  - 85% of rubber;
  - 100% of paddy; and
  - 90% coconut are of small holdings
- 26% of the total population
- More than 70% of the country fall within the SME sector
- SMEs' contribution to the total Gross Domestic Product of the country has increased to 52% in 2011 from 40% in 2010

- SMEs play an important role in economic development through:
  - Creating employment opportunities
  - Mobilizing domestic savings
  - Poverty alleviation
  - Income distribution
  - Regional development
  - Training of workers and entrepreneurs
  - Creating an environment in which large firms flourish
  - Contributing to export earnings

# Importance of SMEs in the Economy (2)

## Key SMEs - Sector-wise

The SME sector dominates agriculture, plantation, construction, manufacturing, trade and other services.

### SMEs in the Services Sector

- Health Services
- Passenger Transport
- Freight Transport
- Banking and Insurance
- Tourism Sector
- Telecommunications
- Construction
- Business Process Outsourcing (BPO)
- Beauty Care Industry

### SMEs in the Plantation and Agriculture Sectors

- Paddy Milling
- Tea
- Rubber
- Coconut
- Fruits and Vegetables
- Minor Crops
- Poultry Industry

### SMEs in the Manufacturing Sector

- Textile and Apparel Industry
- Surgical Gauze Industry
- Leather and Footwear Industry
- Gem and Jewellery Industry
- Edible products, including milk/fish-based products, etc.

# Government Policy Framework and SMEs (1)

- The government policy framework envisages that Sri Lanka will have a stable society, ensuring:
  - a quality living to its people through having access to a decent living, electricity, water, schooling, and health facilities.
- Development goals are to be realized through:
  - a rapid economic growth and by transforming the structure of the economy to be a modern, environmentally-friendly, and well-connected rural-urban economy that can create employment opportunities with better remuneration.

- The vision of the Government of Sri Lanka is to double the country's per capita income to US\$4,000 by 2016 and consolidate Sri Lanka as an emerging economy.
- This requires a growth rate of around 8 percent to be maintained over the years.

# Government Policy Framework and SMEs (2)

## SMEs are being strengthened by the government

- The government has assigned high priority to the SME sector to strengthen the SME as the backbone of the economy.
  - Steps have been taken by the government to form an entrepreneurial development environment by introducing appropriate policy reforms and providing greater incentives for SMEs.
  - The government social welfare schemes are being redesigned to provide stimulus to SMEs:
    - Thripasha;
    - Surgical gauze;
    - Selected pharmaceutical products;
    - School textbooks, uniforms, furniture, etc.
  - Continuation of fertilizer subsidy
  - Planting and replanting subsidies
- SMEs are the central mechanism in the entire operation
  - A vibrant SME sector can play a key role in creating employment opportunities and high economic growth in post-conflict Sri Lanka
  - Hence, SMEs need recognition, support, and considerable synergy to integrate with the real economy



# Recent Policy Changes Related to SMEs (1)

## Investment Fund Account (IFA)

- From the budget in 2011, all banks were required to set up an IFA from the reduction of the corporate income tax collected on banks from 35% to 28% and VAT on financial services from 20% to 12%.
- Instructions were given to the banks to provide funding for SME development programs using the IFA.
- Special SME bank branches were established to utilize IFA and will support SMEs providing guidance for marketing, financial management, changing energy by renewable sources, and increasing productivity and competitiveness.
- A 50% government guarantee will be given for those banks providing loans under IFA to restructure SMEs in order to improve their performance.

### **From the budget 2013:**

- The investment in sustainable energy sources, including solar power, and women's entrepreneurship venture capital projects, up to 10 million Rs each, will be added as qualifying sectors.
- Where the funds in the investment fund account have not been utilized as per the Guidelines by June 30, 2013, the respective institutions are required to transfer the funds lying credit of the funds to the Treasury.

# Recent Policy Changes Related to SMEs (2)

## Income Tax

- The annual turnover, which applies for the concessional income tax rate of 10% for SMEs, has been increased to 500 million Rs.
- Corporate income tax rate on SMEs was reduced to concessional rates of 10 to 12 percent.

Description	Income Tax Rate (%)
Agriculture	10%
Manufacture of any product for export with 65% LVA	
Operation of storage facilities	
Supply of labor	
Educational services	
Development of software	
Small companies (taxable income not exceeding 5 million Rs)	12%
Non-traditional exports	
Livestock, poultry, & animal products	
Tourism & construction	
Manufacture of handloom products	
Healthcare services	
Operation of mini-hydropower projects or other alternative energy sources	

# Recent Policy Changes Related to SMEs (3)

## Income Tax Cont'd...

- Tax holiday period was extended from 3 years to 4 years and further extended to 6 years based on the level of investment
- ESC chargeability simplified by removing the liability on the turnover for any business of which the profits are subject to income tax
- Extend exemption limit of Economic Service Charge (ESC) for enterprises with quarterly turnover up to 50 million Rs
- Chargeability to ESC is exempted on any sale of locally manufactured clay roof tiles and pottery products by a manufacturer
- Write off all unpaid tax liabilities up to March 2009 of all enterprises with annual turnover below 100 million Rs
- Removal of the Debit Tax and Social Responsibility Levy

# Recent Policy Changes Related to SMEs (4)

## Value-Added Tax (VAT)

- Application of a single VAT rate of 12%
- Exemptions:
  - Importation of pharmaceutical machinery and spare parts;
  - Importation of machinery and equipment for bakery products, manufacture of footwear, and bags;
  - Importation of equipments for mini-hydropower projects implemented for the supply of electricity to the national grid;
  - Local manufacture of hydropower machinery and equipment, value-added local products to tourist hotels and airlines, locally developed software, unprocessed agriculture, and fishing;
  - Importation of agricultural machinery and seeds;
  - Importation or supply of lorries and busses, machinery for the production of rubber and plastic products, molding (steel, glass, rubber, or plastic), items needed in the poultry industry



# Recent Policy Changes Related to SMEs (5)

## Nation Building Tax (NBT)

- Reduction of the NBT rate from 3% to 2%
- Amalgamation of NBT and Provincial Turnover Tax
- Exemptions:
  - Importation of equipment for mini-hydropower projects implemented for the supply of electricity to the national grid;
  - Wholesale or retail sale of printing of books and collectors of fresh milk, green leaf, cinnamon, and rubber;
  - Importation of equipment for mini-hydropower projects implemented for the supply of electricity to the national grid;
  - Locally manufactured clay roof tile and pottery products by a manufacturer;
  - Sale of paintings by the creator of such paintings

# Recent Policy Changes Related to SMEs (6)

## Other Special Treatment for the SME Sector

### Tax Concessions to SME Sector (from the Budget 2013)

- Any person or partnership, with an annual liable turnover/ supplies not exceeding Rs.12Mn, from all the businesses carried on by such person or partnership will not be liable to pay VAT and NBT (including NBT on whole sale or retail business).
- Income tax and corresponding indirect taxes payable by any person having turnover not exceeding Rs.300 Mn per year from every trade or business carried on by such person for any period ending prior to April 1, 2011, and not complied with tax laws, will be exempted from payment of such taxes, if the past earnings are invested prior to 31.3. 2014, in any trade or business and duly comply with tax laws
- The profits and income from such trade or business (carried on by capitalizing such earnings) will be exempt from income tax for a period of 5 years.
- **Tax exemptions to individuals returning after the completion of foreign employment**  
Any individual who returns from foreign employment and invest his/her savings to commence new businesses will be exempt from all taxes payable on turnover and on the profits and income from all such new businesses for a period of 5 years.

# Recent Policy Changes Related to SMEs (7)

## Import Duty & Other Trade-Related Taxes

- Application of four band tariff lines of import duty (0%, 5%, 15%, 30%)
- Import duty is 0% or 5% for many inputs / raw materials used by SMEs

0%	5%
Purebred breeding animals	Clays, sulphur, phosphate, cement
Vegetable, fruit, tea seeds	Trishaws for goods transportation, motorcycles
Machinery, mechanical appliances, electrical machinery	Optical, photographic, medical equipments
Plastics, chemical and pharmaceutical products	Hand tools, spoons and forks
Tractors, tankers, bowsers, dumpers	Nickel
Base metals, fertilizers	Some mineral fuels
Fabrics, yarn , synthetic fibers	Industrial or medical plants
Printed books, brochures and leaflets, wood pulp	Containers of packaging

# Recent Policy Changes Related to SMEs (8)

## Import Duty Cont'd.

- Import duty exemptions with the approval of relevant authorities:
  - Prefabricated poultry houses, plant, machinery and equipment, including parts and accessories for poultry industry;
  - Multilayered packaging materials consisting of laminates of paper, polyethylene film and aluminum foil used for packaging of liquid milk, vegetable juice, and fruit juice;
  - Finished leather to be used for the shoe- and bags-manufacturing industry;
  - Ingredients other than maize, lentils, and rice for the manufacturing of animal and poultry food;
  - Raw materials, components, parts, and accessories for the manufacture of fishing boats;
  - Weather stations, greenhouses, polytunnels, sprinklers, drip irrigation systems, and materials for the construction of green houses, polytunnels, drip irrigation systems, and netting for agriculture and related activities;
  - Lacquers, coating, and varnishes used for coating of metal cans and closures used for the packaging of food



# Recent Policy Changes Related to SMEs (9)

## Import Duty Cont'd.

- Use of **industry-specific CESS** to promote local production:
  - Meat, eggs & milk products (butter, yogurt, cheese, curd, etc.);
  - Some types of vegetables, fruits, flowers;
  - Coconut, tea, spices, cereals;
  - Beauty or makeup preparations, shampoos, shaving preparations, soap;
  - Plastic products, natural rubber and rubber products, leather products, paper products
- **Special Commodity Levy** in support of food production – rice, sugar, onion, chili, green gram, etc.



**Thank You**